

Accounting and Reporting for Certain Investments

In March 1997 the Governmental Accounting Standards Board (GASB) issued Statement 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. This statement, effective beginning with fiscal year 1997-98, establishes accounting and reporting standards for certain investments held by governmental entities, including school districts and county offices of education.

GASB Statement 31 requires school districts and county offices to report their investments at fair value on the balance sheet. This requirement is similar to the one for businesses under Financial Accounting Standards Board (FASB) Statement 115, *Accounting for Certain Investments in Debt and Equity Securities*, and to the one for not-for-profit organizations under FASB Statement 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*.

LEAs' investments affected by this statement are:

- Participating interest-earning investment contracts
- External investment pools, including cash with county treasurer
- Open-end mutual funds
- Debt securities
- Equity securities, option contracts, stock warrants, and stock rights

The provisions in GASB Statement 31 apply only to investments that are held primarily for the purpose of income or profit. Most school districts and county offices deposit their receipts and collections of moneys with their county treasurer because they are required to by *Education Code* Section 41001, not "primarily for the purpose of income or profit." However, this still means that the LEA's cash is in external investment pools because most of the county treasurers in California sponsor external investment pools. An external investment pool commingles (pools) the moneys of more than one entity and invests, on the participants' behalf, in an investment portfolio. Because GASB Statement 31 applies to external investment pools, LEAs are required to report their cash in the county treasury at fair value on the balance sheet. However, see paragraph titled "Materiality of Adjustments to Fair Value" on the last page of this procedure.

GASB Statement 31 provides certain exceptions to the general rule requiring that investments be reported at fair value. These exceptions include:

- Investments with a remaining maturity of one year or less at the time of purchase
- Nonparticipating investment contracts, such as nonnegotiable certificates of deposit
- Investments in 2a7-like pools, which are external investment pools that adopt policies similar to those of private companies that operate under the Securities and Exchange Commission's Rule 2a7 of the Investment Company Act of 1940. They invest only in short-term securities and are required to sell securities whose market values deviate more than a set percentage from amortized costs.

Determining Fair Value

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value is determined from the published market price in newspapers or trade journals and quotes from recognized stock exchanges or over-the-counter markets. For investments without a quoted market price, the fair value may be determined by using the market price of similar instruments, discounted cash flow, or any other valuation technique that provides the best estimates. The fair value of investments in external pools (i.e., cash in the county treasury) is based on the fair value of the pools' underlying portfolio. LEAs should obtain this information from their county treasurer.

Recognition and Reporting of Investment Income

All investment income, including changes in the fair value of investments, should be recognized as revenue on the operating statement. The change in fair value of investments should be captioned "net increase (decrease) in the fair value of investments." Realized gains and losses should not be reported separately from unrealized gains and losses except in the notes to the financial statements.

There are two revenue object accounts for reporting investment income:

- Object 8660, Interest
- Object 8662, Net Increase (Decrease) in the Fair Value of Investments

All investment income, other than changes in the fair value of investments, should be reported in Object 8660. The changes in the fair value of investments, which include realized and unrealized gains and losses, should be reported in Object 8662.

The change in the fair value of investments is defined as the ending fair value, plus proceeds from investments maturing or sold during the year, less investment purchases made during the year, less the beginning fair value. If the fair value of the investments at the beginning of the year differs from the reported value at the end of the prior year, the

difference should be reported as a “restatement of beginning fund balance” in Object 9793 of Forms J-200/400/600 or Object 9795 in SACS.

The following examples illustrate how to calculate the changes in the fair value for cash in the county treasury and the accompanying accounting entries. The examples cover two fiscal years.

Note that Object 9110, although titled Cash in County Treasury, really represents the book value of the LEA’s share of an external investment fund. However, for most purposes Object 9110 is administered as a cash account. Therefore, to avoid making non-cash-adjusting entries to this “cash” account, entries for unrealized gains or losses on the value of cash with the county treasurer are made to Object 9111, Fair Value Adjustment to Cash in County Treasury.

Fiscal Year 1997-98

Assume that a school district had \$100,000 cash in the county treasury with a fair value of \$105,000 as of July 1, 1997. The district had deposits of \$900,000 and disbursements of \$925,000 during the fiscal year. As of June 30, 1998, the district’s cash in the county treasury is \$75,000, with a fair value of \$78,000.

The change in fair value is calculated as follows:

Fair Value, ending 6-30-98	\$ 78,000
Add: Disbursements (comparable to proceeds of investments sold)	925,000
Less: Receipts (comparable to costs of investments purchased)	(900,000)
Less: Fair Value, beginning 7-1-97	<u>(105,000)</u>
Net increase (decrease) in fair value for fiscal year 1997-98	<u>\$ (2,000)</u>

Although the fair value of the cash in the county treasury is \$3,000 (\$78,000 minus \$75,000) higher than the actual cash balance at year-end, the change in fair value is a decrease of \$2,000 during the fiscal year. This is due to the restatement of \$5,000 (\$105,000 minus \$100,000) to the beginning fund balance to recognize the fair value of cash at the beginning of the fiscal year.

The entries are as follows:

<i>Date</i>	<i>Account</i>	<i>Debit</i>	<i>Credit</i>
6-30-98	DR Fair Value Adjustment to Cash in County Treasury	\$3,000	
	DR Net Increase (Decrease) in the Fair Value of Investments	2,000	
	CR Restatement of Beginning Fund Balance		\$5,000
To report the ending cash balance at fair value, to adjust for the current year’s decrease in fair value of investments, and to restate beginning fund balance due to the fair value of cash at the beginning of the fiscal year			

Fiscal Year 1998-99

Assume that during fiscal year 1998-99, the cash in the county treasury had deposits of \$1,000,000 and disbursements of \$985,000. As of June 30, 1999, the cash in the county treasury is \$90,000, with a fair value of \$94,000.

The change in fair value is calculated as follows:

Fair Value, ending 6-30-99	\$ 94,000
Add: Disbursements (comparable to proceeds of investments sold)	985,000
Less: Receipts (comparable to costs of investments purchased)	(1,000,000)
Less: Fair Value, beginning 7-1-98	<u>(78,000)</u>
Net increase (decrease) in fair value for fiscal year 1998-99	<u><u>\$ 1,000</u></u>

Although the difference in the fair value of the cash is \$4,000 (\$94,000 minus \$90,000) higher than the actual cash balance at year-end, the change in fair value is an increase of \$1,000 during the fiscal year. The other \$3,000 in the fair value of cash was recognized at the end of the prior fiscal year.

The entries are as follows:

<i>Date</i>	<i>Account</i>	<i>Debit</i>	<i>Credit</i>
6-30-99	DR Fair Value Adjustment to Cash in County Treasury	\$1,000	
	CR Net Increase (Decrease) in the Fair Value of Investments		\$1,000
	To report ending cash balance at fair value and the increase in fair value of investments		

Another option follows:

LEAs may choose to reverse their fair value entries for the cash in the county treasury at the beginning of the fiscal year. However, this method would not be necessary for their other investments. If the LEA elects to reverse the entries, then they are as follows:

<i>Date</i>	<i>Account</i>	<i>Debit</i>	<i>Credit</i>
7-1-98	DR Net Increase (Decrease) in the Fair Value of Investments	\$3,000	
	CR Fair Value Adjustment to Cash in County Treasury		\$3,000
	To reverse the entries for reporting cash at fair value		
6-30-99	DR Fair Value Adjustment to Cash in County Treasury	\$4,000	
	CR Net Increase (Decrease) in the Fair Value of Investments		\$4,000
	To report ending cash balance at fair value and the change in fair value of investments		

Designation of Fund Balance for Net Unrealized Gains

The LEA may designate that portion of the fund balance attributable to the fair value changes for net unrealized gains to make clear that it is not available for spending. By designating the fund balance, the LEAs' management is indicating its intent not to liquidate investments to realize reported gains. However, LEAs should not designate the fund balance for net unrealized losses, because they cannot plan to spend negative balances.

The designation of fund balance should be reported in Object 9715, Designated for Unrealized Gains of Investments and Cash in County Treasury in the Forms J-200/400/600, or Object 9775 in SACS.

Materiality of Adjustments to Fair Value

Generally accepted accounting principles (GAAP) require that LEAs report their cash in the county treasury at fair value. However, like all GASB statements, GASB Statement 31 states that it does not apply to nonmaterial items. For many LEAs, the difference between the fair value and the book value of their cash in the county treasury may not be material.

If an LEA chooses not to record the adjustment necessary to report its cash with the county treasurer at fair value, the LEA's independent auditor must determine whether the omission is material enough to the financial statements to require an adjustment and whether the LEA's departure from GAAP is significant enough to impact the auditor's opinion on the financial statements.

